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SENSITIVE

E.O. 12958: N/A
TAGS: ETRD ECON JA ZO EAGR
SUBJECT: The Japan Economic Scope - February 23, 2007

Sensitive but unclassified. Please protect accordingly.

¶1. (U) This cable contains the Japan Economic Scope from February 23, 2007.

¶2. (U) Table of Contents

¶3. (SBU) Vice President Cheney's Visit to Japan

Vice President Cheney visited Tokyo February 20-22, meeting PM Abe, Chief Cabinet Secretary Shiozaki, and FM Aso. He also received briefings from several Japanese and U.S. military officers, held a troop rally at Yokosuka Naval Base, and had an

audience with the Emperor.

News coverage of the vice president's visit was very full, with all events covered. Largely positive, the press coverage focused on the themes of U.S.-Japan cooperation in the six-party talks, the strength of the alliance, and Iraq.

¶4. (SBU) Council on Economic and Fiscal Policy Reflects on Regulatory Reform
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The Prime Minister's Council on Economic and Fiscal Policy on February 16 took up regulatory reform, reiterating its importance as "an engine for economic growth," that can unleash innovation, contribute to regional revitalization, and raise productivity particularly in the services sector.

Takao Kusakari, Chairman of the Council on Regulatory Reform (CRR), elaborated on its priority areas and cited some examples on possible deregulatory measures, e.g., online medical receipts, one-stop trade procedures, regulatory reform to realize the Asian Gateway concept, reform of agricultural land use and financing. The private sector members of the Council -- including Keidanren Chairman Fujio Mitarai and a number of senior academic figures -- pointed to the work that remains even after a decade of progress on reform, particularly in areas such as medical care, agriculture, elderly care, education, and day care. They recommended, for example, that the price of medical services should reflect demand rather than solely be on a cost-basis, and agreed that online medical receipts should be made available soon. On agriculture, they emphasized the need for land reform including the introduction of long-term leases, land ownership by food companies, and consolidation of unused agricultural land.

The Council stressed the need to examine what is not working in the Special Zones initiative. The private sector members suggested that the Expert Committee should negotiate directly with ministries on selected proposals, and that the CRR could use Special Zones as an option to realize certain regulatory reform. The Cabinet will adopt a new Three-Year Regulatory Reform plan in June, which kicks off the fifth round of the three-year cycle.

¶5. (SBU) Triangular Mergers: the Good, the Bad and the Possibly Ugly
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MOF draft legislation provides capital gains deferral to shareholders of companies acquired by a foreign parent through stock-swaps using a Japanese subsidiary, according to what METI officials told ECOUNS on February 20.

The acquired company, however, may owe taxes on the market value of its assets compared to the book value, depending on characteristics of the subsidiary used to acquire the company, as stated in a LDP tax committee decision last December.
MOF is in the process of interpreting this decision, and the requirement that the subsidiary be a company "working" in Japan could prove problematic.

On the issue of which stocks could be used in the swap without requiring more-than-super-majority voting, the officials said the LDP corporate law committee had discussed this several times with no adverse result, but a final discussion will take place in March.

We will continue to urge regulations on both issues that will enable triangular mergers to be a useful tool for new investment is Japan.

¶6. (SBU) Doha and Japanese Agriculture - the Wagons Remain Circled?

The Vice Minister for International Affairs at the Agriculture Ministry, Hidenori Murakami, headed to London this week seeking

bilateral meetings with counterparts from the United States, the European Union, Brazil and India to discuss the Doha Development Agenda.

Japan has very little new to offer to advance the Doha Round -- at least for public consumption -- but the Agriculture Ministry (MAFF) remains concerned that the other parties to the talks could be working to cut a deal that would leave Japan unprepared. Officials continue to tell us they do not want a repeat of what happened at the end of the Uruguay Round, when Japan was forced to accept a deal on agriculture largely struck in bilateral talks between Washington and Brussels.

Meanwhile, the press this week played up a comment from Agriculture Minister Toshikatsu Matsuoka that the G10 countries and EU were discussing the possibility of a joint proposal on sensitive items for agriculture. The Embassy talked to a contact at MAFF about the story. He told us that the remarks were taken out of context, these discussions had been ongoing for over a year, and there was nothing new to report.

Matsuoka indicated after the informal ministerial meeting in Davos in January his interest in pursuing bilateral talks with key countries. Part of his purpose has been to round up support among key like-minded countries, such as India, bent on protecting their agricultural sectors. Matsuoka indicated he wants to stay in touch with Indian Trade Minister Nath.

¶7. (SBU) Japan-Australia FTA: No Date for Launch Yet

Since the announcement in December that Japan and Australia would launch negotiations on an Economic Partnership Agreement there is still no date for the two the sides to have their first meeting. On February 15 protestors were all over the streets of Kasumigaseki -- where the key ministries responsible for the EPA negotiations have their offices -- to condemn the initiative. Afterward, the organizers of the protest, including Japan Agriculture, the large cooperative that protects Japan's small

farm interests, took their complaints to the neighborhood in Mita where their shouts could be heard by the Australian Embassy. The Japanese press has put the spotlight on the opposition: The Asahi Shimbun on February 21 described the "rural unrest" the Japanese government faces as it contemplates when to launch the talks.

For his part, the Australian ambassador, Murray McLean, is making the case that an agreement will be a boon for both countries' economies. He told a Fukuoka- based daily that Australia will insist that a partnership agreement include agriculture, although he has hinted that tariff reductions could be phased in over a longer period. A deal, McLean said, could add up to $5.4 billion annually to Japan's GDP.

Meanwhile, a JA delegation was in Australia for meetings with their counterpart organizations on February 20-24. There is no word yet on how the discussions have gone. JA told us before the visit that they had no particular agenda, except to express the organizations concerns about an EPA, and to do some fact finding. According to Asahi, however, in what is probably a more accurate characterization, JA is lobbying Canberra to exclude sensitive agricultural goods from a deal.

We have sought a status report on the talks at MOFA and the Australian Embassy. An official in MOFA's Economic Partnership Division was very cautious.

Since the December announcement, she told us, "nothing has happened." She pointed out that the problem was in part a "manpower" issue for the ministries, which were otherwise stretched thin right now in other negotiations. She conceded, however, that the situation was "very delicate," particularly at the Agriculture Ministry, where the bureaucrats are fighting what another observer described to us as a "rear guard effort" to

scuttle the negotiations.

At the Australian Embassy on February 20, an official underscored that the economics of a deal were good for both countries, but recognized that in advance of Upper House elections in July, progress will be slow.

¶8. (SBU) BSE Update

There continues to be fallout from the discovery earlier this month of a couple of packages of beef banned under the export agreement that Tyson Fresh Meats inadvertently shipped to Japan. In the Diet, Agriculture Minister Matsuoka and Health Minister Yanagisawa fielded at times difficult questions on the subject, with Matsuoka stating that he saw no significant flaws in the BEV program. Replying to one suggestion, the ministers said it would be difficult for Japan to insist on blanket testing by its trading partners.

Meanwhile, bowing to what continue to be relatively uninformed consumer sensitivities, officials at Seiyu, a nationwide department and grocery store chain majority-owned by Wal Mart, told us that it had decided to delay its (internal) plans to market U.S. beef.

According to press reports, two consumer interest groups -- the Consumer Union of Japan and the Food Safety Citizen's Watch -- submitted requests to Matsuoka and Yanagisawa to block all U.S. beef imports. The request came after Tyson admitted that it had erred in shipping some beef to Japan that did not meet the agreement between the two countries.

The GOJ has been fairly measured in its reaction since issuing a press release on the incident February 16. Press coverage, although continuing to gloss over the facts about BSE, has been less sensationalistic than in the past. Authorities have refused to discuss further market opening while the Tyson incident is still being studied.

¶9. (U) Universal Studio Japan listed on Mother's Board of Tokyo Stock Exchange
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Universal Studio Japan in Osaka announced that the company would

be listed on the "Mother's Board" (for new listings) of the Tokyo Stock Exchange starting in March. After many years of debt, the company expects to see a profit for the current fiscal year ending in March, for the first time since opening in 2001. Currently Goldman Sachs (GS) holds about 48 percent of USJ's stock, Development Bank of Japan has 11 percent, and Osaka city government has 10 percent.

The USJ Japanese sales manager commented that the amusement park has been increasing its attractions and expanding its business, so the firm is eager to use the market for more financing.

¶10. (U) New Trade Insurance for Japan's Energy Supply

At a press conference on February 20, METI Minister Amari announced the establishment of new trade insurance to ensure Japan's energy supply.

As a part of efforts to expand more aggressive and strategic energy diplomacy, the new insurance plan will be established and sold starting this April. In the current trend of strengthening state control of energy resources and escalation of competition for energy resources, it is necessary for the government to be out in front strategically, Minister Amari said. METI will use this new trade insurance as an important energy diplomacy tool, and work strategically with the private sector to ensure the supply of natural resources.

The outline of the new insurance is as follows: The Independent Administrative Corporation (Nippon Export and Investment Insurance (NEXI)) will accept the insurance. The GOJ will accept the reinsurance, thus, the GOJ will cover the risk.

The ceiling of acceptance will be 300 billion yen and the premium rate will be "irresistibly" low -- or 50 to 75 percent below the current rate -- so that it will be accessible for private development entities. Projects will be 100 percent covered for both political and commercial risks.

When a private entity negotiates alone with another government, it is difficult for the GOJ to get involved in the negotiations with the other government; however, if we provide insurance, the GOJ will be one of the interested parties, therefore, the GOJ would be able to get involved in government to government negotiations.

¶11. (SBU) Kyushu Electric Expands Business Ties with India

On February 19, Kyushu Electric Power (Kyuden) became the first private Japanese utility to sign a Memorandum of Agreement (MOA) with National Thermal Power Corporation (NTPC), India's largest and mostly state-owned power producer, to explore possible joint business development.

As part of its aggressive expansion strategy abroad to increase business performance and profitability, Kyuden had already entered into similar agreements with 13 other companies in 10 countries/regions.

While no specific business plans have been announced, Kyuden aims to offer consultancy in power efficiency and environmental protection technologies as well as participating in power plant construction.

A Kyuden official notes that the MOA is also partly the result of a request by Japanese companies operating in India (i.e., Suzuki Motors) for more stable power sourcing.

¶12. (SBU) Medical Devices and Pharmaceuticals Working Group Meetings in Tokyo
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Good news emerged that could speed the approval process for new drugs in Japan during Regulatory Reform talks February 8-9 in Tokyo.

After some U.S. prodding about Japan's glacial approval process for innovative new drugs, Japan's Pharmaceuticals and Medical

Devices Agency (PMDA) agreed to double the number of drug reviewers over three years to roughly 400.

To fund the increase, authorities plan to introduce higher user fees for new drug reviews, effective April 1. When the U.S. delegation expressed reservations that the increase in user fee costs would be introduced without also being tied to performance metrics, the Health Ministry (MHLW) agreed to extend the public comment period until the end of February.

Also during the talks, the U.S. side expressed appreciation to MHLW for the decision not to impose annual price cuts in
¶2007. The issue is expected to come up again in April
¶2008. Throughout the talks the Commerce-led delegation emphasized the need to seek input from U.S. industry, especially before making broad changes to the healthcare system.

The next round of talks is slated for early April in Washington. The final round of talks will occur in late May/early June, when the Report to the Leaders is discussed.

¶13. (SBU) IPR Cooperation: USPTO and JPO Share Info, Seek to Coordinate IPR Training Programs

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Following up side meetings during the week of Regulatory Reform talks in Tokyo in January, the US Patent Office (USPTO) and the Japan Patent Office (JPO) have begun exchanging schedules and information on their training and assistance programs, particularly in Asia.

USPTO is also proposing a meeting in Bangkok this spring to bring together the main donor countries providing IPR training in Asia, including USPTO, JPO, ECAP (the European EC-ASEAN Intellectual Property Rights Co-operation Programme) and IP Australia, to discuss information-sharing and better coordination among their various activities and programs.

¶14. (U) Survey Says: Four of Top Five Best Places to Work in Japan Are U.S. Companies
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Nikkei Business magazine published in its February 19 issue the results of an annual survey on Japanese workplace conditions conducted by the Great Place to Work Institute Japan (GPTWJ). Four of the top five companies on the list of best places to work in Japan were U.S. firms.

The Japanese job search agency Recruit Agent received the highest score, followed by Morgan Stanley, Microsoft, Eli Lilly and Hewlett-Packard. GPTWJ collected survey data from 62 companies in Japan utilizing two methods: an online questionnaire sent to companies about company culture, office infrastructure, opportunities for advancement and employee benefits; and an online questionnaire sent to individual employees about feelings towards management and the company as a whole as well as employee levels of enthusiasm for their work.

Post's contact at Eli Lilly in Sapporo confirmed his company's participation in the survey, explaining that 400 Eli Lilly employees were randomly selected to respond to the questionnaires.

¶15. (SBU) Autos: U.S. Automakers in Japan on Alleged Currency Manipulation Question
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Ford responded to our inquiry to the Big 3 in Japan for commentary on early February news reports that the Big 3, buttressed by former Treasury Undersecretary for International Affairs John Taylor's revelations in his book Global Financial Warriors that the Japanese intervened the currency markets, had launched a campaign to get the Administration to oppose alleged currency manipulation by Japan.

Ford referred us to a 2006 report produced by the Automotive Trade Policy Council, entitled, "The Economic Impact of Japanese Currency Manipulation," which the automakers are using on the Hill to make their case. (A 2005 version of the report is available on the ATPC website. The 2006 report is a 2MB file. Please contact Joy Progar if you want a copy.)

The 13-page report has some quotes from Japanese government officials, Japanese auto industry executives, and financial analysts that suggest the Japanese government does intervene in the currency markets to keep the yen's value artificially low and provides a series of graphs and charts showing the effect of the low yen on the auto market in the United States.

Ford also provided some talking points from their U.S. office which underscored the importance of this issue to Ford. (See attached e-mail)

Finally, Ford reported in their discussions with METI in late 2006, it became apparent Japan had two key strategies for developing the Japanese auto industry: global technological leadership, particularly through hybrids, and more exports, as there is not an expectation of any great growth in domestic auto

demand.

Ford took from these discussions that facilitating more exports is a GOJ objective and a weak yen is helpful to this end.

¶16. (SBU) CivAir: Kobe Airport's First Year: Little Cause for Celebration
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Kobe Airport (UKB), which opened last February, will not meet its first year sales and passenger targets. Kobe City estimated 3.19 million passengers in the first year, but UKB is 500,000 passengers short of that goal.

The average annual load factor for all routes combined was 61.3 percent, with a low of 52.7 percent in January 2007. Cargo volume is worse: Kobe only moved half of the target, at 24,000 tons.

The city government, which runs the airport, started issuing public bonds in 1999 to raise 200 billion yen for land purchase and airport construction. The city's financing plan appears to have been wildly optimistic: Kobe has only sold 0.3 ha of the 82.6 ha of public land it had intended to sell in order to pay for the bonds, keeping the city in heavy debt. A source in the city government says it will consider dropping its asking price for the property it is offering.

On the other hand, the airport's non-aviation business has had a modest positive impact on the local economy. Since last February, more than 30 companies, both domestic and foreign, have started operating on neighboring Port Island, including Boehringer Ingelheim, BMW group, and Estee Lauder. Local hotels are reporting an increase in customers from the new airport.

¶17. (SBU) KIX Upbeat on Upcoming Aviation Bilat

Kansai International Airport Company officials told ECOUNS and Econoff in Kyoto that in upcoming bilateral aviation talks, the airport officials think MLIT is prepared to be more flexible on "Open Skies" services than in the past, for airports outside of Tokyo, if the USG is flexible on new Narita slot allocations. For more details of this, views on PM Abe's Asian Gateway concept, and other civair insights, please see Osaka Kobe 00036.

¶18. (U) Internationalizing Hokkaido's Civil Aviation Industry
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Although Hokkaido's civil aviation industry is well equipped to support international air travel, the market for such travel remains underdeveloped. Despite heavy domestic traffic in Japan, the number of direct international flights to Sapporo's New Chitose International Airport is limited.

Hokkaido government officials are initiating a number of policies aimed at transforming New Chitose into an international hub. However, stronger local political support for the proposed Hokkaido Shinkansen bullet train project and rising oil prices both present tough obstacles to making this a reality. For more information, please see Sapporo 0009.

¶19. (SBU) Rail: Shinkansen Tech Transfer to China; California

High Speed Rail

The press in January and February reported on the start of high-speed rail services in China using JR East's E-2 1000 Hayate Shinkansen trains. Sixty trains consisting of eight-car sets have been ordered by China, over 50 of which are to be constructed in China on the basis of technology transfer.

News reports were unclear as to how much of this crown jewel of Japanese transportation technology had been given away. Econoff

approached an official of JR Central for commentary.

The JR Central official felt that JR East had given away the store. He related how a consortium of Shinkansen manufactures led by Kawasaki Heavy Industries and including Japanese trading companies had wanted to sell the high-speed trains to China. He explained that the three Japanese passenger rail companies, JR West, JR Central and JR East, however, own the design rights to the Shinkansen trains they operate. Each rail company has its own team of engineers that creates design specifications based on the common Shinkansen technologies they all inherited in 1987 with the breakup of Japan National Railways. Manufactures then produce trains to their designs.

In the case of overseas sales, he noted, JR Central prefers to sell the whole system -- wagons, control systems, high-speed signal system, tracks, etc. -- to maximize the sale and ensure that high safety standards are maintained. China, however, wanted to pick and choose the technology it wanted to buy. JR East, he said, was willing to sell just the train design along with its control and signal system and so that is how China ended up with the E-2 train.

According to him, all parts of the wagons, including the sophisticated distributed electric motors that drive the train, will be manufactured in China.

The JR Central official worried about this tech transfer. Not only does it give the Chinese the potential to copy and build the wagons themselves for domestic use or export, but he speculated that there might be some military tech transfer.

Econoff also contacted the California High Speed Rail Authority about their manufacturing plans for the State of California high-speed rail system when it is built.

They responded that it is estimated that 300,000 job years will be needed for the construction of the system and an additional 450,000 jobs will be generated throughout the state as a result of the train system. They said, however, it was too early to decide whether the wagons would be manufactured in California.

¶20. (SBU) Maritime: MLIT's International Shipping Division's Work and Reg Reform
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EconOff and EconFSN met with MLIT's International Shipping Division on February 20 to discuss the work of the Maritime Subcommittee, the Maritime Economic Council and the Asia Gateway Initiative in order to understand developments in Japanese shipping policy and address some questions from the Federal Maritime Commission, possibility relating to U.S. regulatory reform initiatives vis--vis Japan.

The Maritime Subcommittee is looking at ways to increase the number of Japanese flagged ships and seafarers through changes in the tax structure. In addition, it is examining how to end a program that buys out small and medium sized shipbuilding enterprises to reduce over capacity in the industry.

As a result of a request from the Japanese Fair Trade Commission, the Maritime Economic Council is reviewing whether liner conferences are anti-competitive. MLIT has concluded they are not, but the Council is looking into this matter nonetheless. The International Shipping division is examining safety and environmental issues for shipping in the Straits of Malacca as its contribution to the Asia Gateway initiative.

For a memo on the meeting with more information see the attached.

¶21. (U) Regions: Western Japanese Business Leaders Debate Reforms and Workplace Issues in Kyoto
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Major business organizations in western Japan held the Kansai Zaikai Seminar (Kansai Economic and Management Summit), the largest annual business event in the Kansai region, February 8-9 in Kyoto. LDP Secretary General Hidenao Nakagawa gave the keynote address, and Senichi Hoshino, Senior Director of the Hanshin Tigers, also delivered a business leadership lecture. The participants broke into seven groups to discuss economic topics of interest, but the most heated discussions were about corporate ethics in the face of repeated business scandals across Japan, and about the decline in the birthrate, productivity, educational standards of the workforce, and related labor issues. Employers described the difficulty in changing the ratio of regular employees to contractors, although there was wide acceptance that this was a problem that needed urgent rectification.

There was a high level of interest in pushing for civil service reform and institution of doshusei decentralization in the Kansai, the latter of which the business community here has promoted for decades. There was wide support for businesses playing a bigger role in education reforms, and support for PM Abe's education reform platform-along with criticism of the slow pace of actual reforms. Executives such as Daikin Industry's Noriyuki Inoue called for changes to Japan's "relaxed" education program in order to revive the elite education model.

Other Osakan business leaders were unable to hide their unease at the pace of globalization and westernization of the Japanese economy, while at the same time improving their balance sheets through Western management techniques, FDI, and an increasing amount of M&A activity.

There was open hostility to the idea of boosting the declining workforce through immigration, with executives citing French and British immigrant community unrest while rejecting the applicability of the U.S. immigration model in Japan. There was a high level of support for increasing meaningful employment opportunities and flexible work modes for women, especially when faced with the choice of either boosting immigration or increasing the participation of women in the Japanese workforce.

¶22. (U) BOJ Raises Short-Term Policy Rate to 0.5%, First Rate Hike in Seven Months
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On January 21 the Bank of Japan Monetary Policy Board decided to raise its operating target for the uncollateralized overnight call money rate by a quarter point to 0.5 percent.
This is the second rate hike since last July, when the BOJ raised the policy rate to 0.25 percent by terminating the zero interest rate policy (ZIRP).

In making this decision, the Board cited as determining factors the likelihood of both continued modest expansion of the economy with a moderate increasing trend of private consumption, and an increase in consumer prices over a long-term perspective, as well as its concerns about the increasing simulative effect of monetary policy on economic activities.

The Board indicated that it would adjust interest rates "gradually," and would maintain an accommodative stance with very low interest rates for some time. Please see attached document for more details.
DONOVAN